

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
<http://www.in.gov/legislative>

FISCAL IMPACT STATEMENT

LS 6041

BILL NUMBER: HB 1608

NOTE PREPARED: Jan 5, 2015

BILL AMENDED:

SUBJECT: Deduction for Investment Interest.

FIRST AUTHOR: Rep. Smaltz

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X **GENERAL**
DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill allows an individual to subtract investment interest payments in the calculation of the individual's Indiana adjusted gross income if the investment interest payments are: (1) made with respect to tangible property held for investment in Indiana; and (2) deducted from federal adjusted gross income for federal income tax purposes.

Effective Date: January 1, 2015 (retroactive).

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR will incur additional expenses to revise tax forms, instructions, and computer programs to enact the provisions in the bill. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Summary-* This bill allows individuals to deduct the amount of interest paid on money borrowed that is allocable to tangible property held for investment when computing their Indiana AGI. The deduction equals the investment interest relating to tangible property the taxpayer claimed as a deduction on their federal income tax return. The deduction applies to taxable years beginning in 2015. The revenue impact will likely begin in FY 2016, but could begin in FY 2015 if taxpayers adjust their quarterly estimated tax payments. The deduction may reduce state General Fund revenue by an estimated \$1.3 M to \$2.2 M beginning in FY 2016. The revenue loss will continue in subsequent years. The estimate was derived from an analysis of data published by the Internal Revenue Service.

Additional Information- For federal income tax purposes, a taxpayer is allowed to deduct certain investment interest expenses incurred in a taxable year. The deduction applies to interest on money borrowed to buy

property that will produce investment income or property that the person expects to appreciate in value, allowing the individual to sell it at a gain in the future. The investment property purchased may be either tangible or intangible. The individual cannot deduct interest incurred to generate tax-exempt income. In addition, interest allocable to passive activities, home mortgage interest, and personal interest expenses are not considered to be investment interest. The federal deduction is limited to the taxpayer's net investment income in the taxable year. The amount of investment interest that is not deducted in a tax year because of this limitation may be carried over.

The Indiana investment interest expense deduction is limited to only the interest paid on money used to buy tangible property held for investment. Tangible property is property that has a physical existence such as land, livestock, collectibles, and precious metals. The bill does not allow for the deduction of investment interest expenses for intangible property such as stocks, bonds, certificates, patents, or copyrights.

Explanation of Local Expenditures:

Explanation of Local Revenues: This bill will reduce state taxable income for individuals, so counties imposing a local option income tax (LOIT) could experience a decrease in revenue. Using the median LOIT rate of 1.45%, LOIT collections on a statewide basis could be reduced by an estimated \$0.6 M to \$1.0 M in FY 2016 and FY 2017. The revenue loss will continue in subsequent years.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with a local option income tax.

Information Sources: Internal Revenue Service, Statistics of Income - *Table 2.1 Returns with Itemized Deductions: Sources of Income, Adjustments, Itemized Deductions by Type, Exemptions and Tax Items, Size of Adjusted Gross Income, Tax Year 2012*, July 2014; Internal Revenue Service, Statistics of Income - *Table 1.3 All Returns: Sources of Income, Adjustments, Deductions, Credits and Tax Items, by Marital Status, Tax Year 2012*, July 2014; Internal Revenue Service, Statistics of Income - *Table 2: Individual Income and tax Data, by State and Size of Adjusted Gross Income - Indiana, Tax Year 2012*, July 2013; Internal Revenue Service, *Investment Income and Expenses, Publication 550*, January 7, 2014; Internal Revenue Service, *Sales of Capital Assets Reported on Individual Tax Returns, 2008-2009*, August 14, 2013.

Fiscal Analyst: Heath Holloway, 232-9867.